CIA/OER/IM 71-22 S AFRICA BALANCE OF PAYMENTS
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CIA/OER/IM 71-22

DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

South Africa: Balance-Of-Payments Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1971

INTELLIGENCE MEMORANDUM

South Africa: Balance-Of-Payments Prospects

Introduction

South Africa is faced with an increasing current account deficit that is likely to induce the government to restrict the economy's growth during 1971-75. Although some of the recent acceleration in imports can be attributed to cyclical factors, the deficit also reflects an underlying long-term structural imbalance in the economy that will lead to continuing foreign exchange difficulties. The balance-of-payments outlook is complicated further by South Africa's obligation to remove residual import restrictions under the GATT and by the possibility of the UK's entry into the Common Market. The Republic's reserve position currently is strong, and it continues to benefit from a relatively substantial capital inflow, but both are expected to decline.

This memorandum examines South Africa's balance-of-payments prospects through 1975. The relationship between the components of the balance of payments and of the national economy will be considered and the factors behind the deteriorating balance-of-payments situation identified. The impact of foreign exchange stringency on the economy also will be assessed and some of South Africa's policy options examined.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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Balance-of-Payments Trends

1. During the year ending 30 June 1970, South Africa had the largest current account deficit in its history.* The deficit, approximately $650 million, followed a surplus of $10 million a year earlier (see Table 1). The large deficit can be attributed to an increase of $610 million in merchandise imports and an increase of $160 million in service payments to the rest of the world -- increases that were offset only partly by an expansion in gold output and increased export sales.**

2. South African merchandise imports in 1969/70 were $3,411 million, 22% greater than in 1968/69. The sharp rise in imports was spurred by an increase of well over 12% in gross domestic product (GDP) at current prices and over 7% in real terms. This very high rate of growth in economic activity was associated with a substantial increase in all the major expenditure components, particularly private and public consumption and inventory investment.

3. The current account deficit was partly offset by a substantial net capital inflow. In 1969/70, $344 million in private capital, both short- and long-term, flowed into the Republic. In addition, the South African government and South African public enterprises borrowed $42 million abroad. A deficit of $265 million remained, which was financed by a drawing down of gold reserves.

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* *Although this memorandum is concerned primarily with the balance-of-payments prospects of the Republic of South Africa, accurate data are available only for the South African Customs Union as a whole. The Union, in addition to South Africa, includes South-West Africa (Namibia), Botswana, Lesotho, and Swaziland (see Figure 1). The Republic accounts for about 95% of the Union's national income and trade.*

** *South Africa treats net gold output as a current account receipt and changes in gold holdings as a means of financing balance-of-payments deficits or of accumulating surpluses.*

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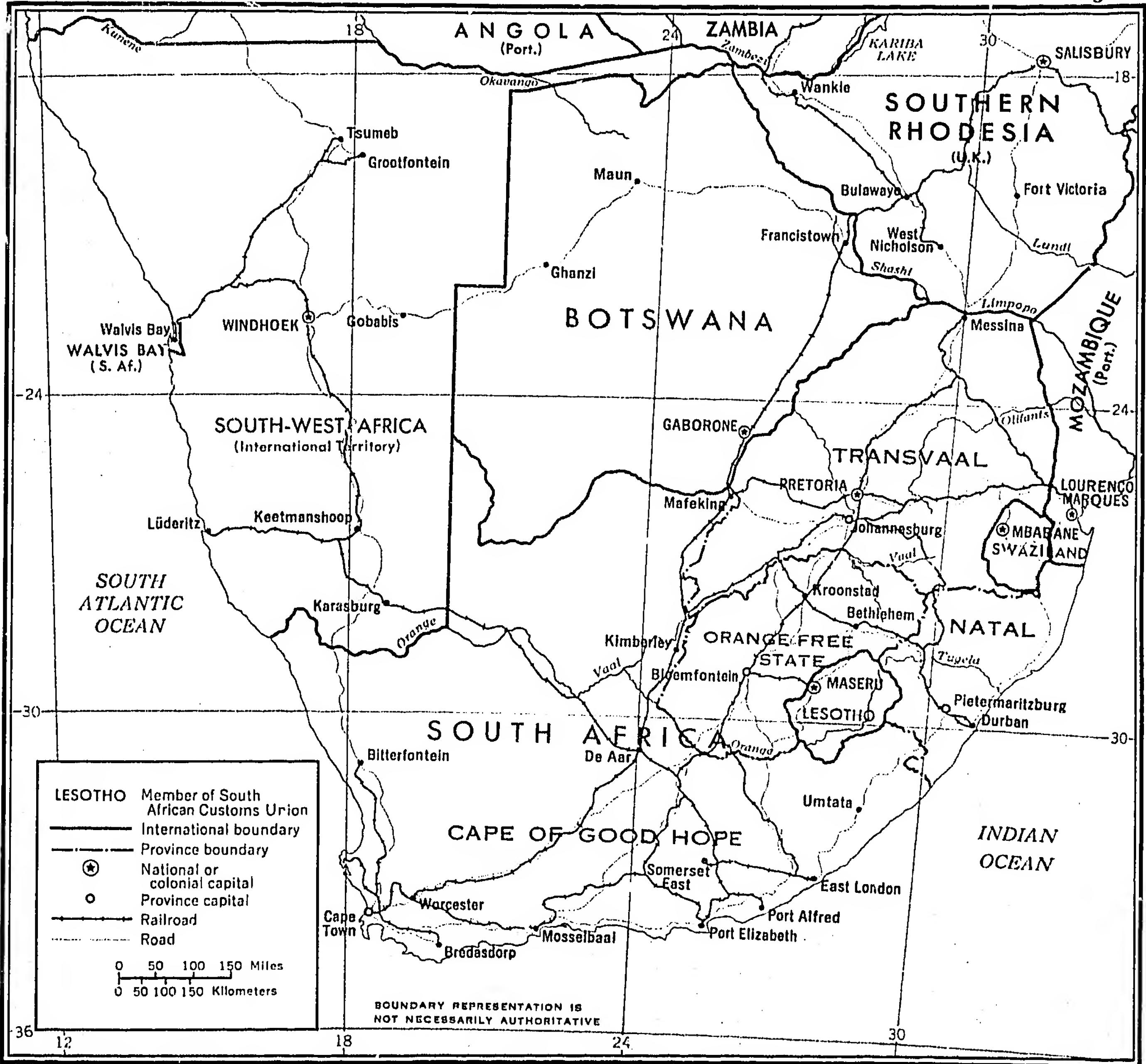
SOUTH AFRICA
Figure 1
ANGOLA
(Port.)
ZAMBIA
KARIBA LAKE
SALISBURY
Wankie
SOUTHERN RHODESIA
(U.K.)
Tsumeb
Grootfontein
Maun
Bulawayo
Fort Victoria
Francistown
West Nicholson
Ghanzi
Messina
BOTSWANA
MOZAMBIQUE
(Port.)
Walvis Bay
WALVIS BAY
(S. Af.)
WINDHOEK
Gobabis
SOUTH-WEST AFRICA
(International Territory)
GABORONE
TRANSVAAL
PRETORIA
Mafeking
LOURENCO MARQUES
Lüderitz
Keetmanshoop
Johannesburg
MBABANE
SWAZILAND
SOUTH ATLANTIC OCEAN
Karasburg
Kroonstad
Bethlehem
NATAL
Kimberley
ORANGE FREE STATE
Bloemfontein
MASERU
LESOTHO
Pietermaritzburg
Durban
SOUTH AFRICA
Bitterfontein
De Aar
Umtata
INDIAN OCEAN
CAPE OF GOOD HOPE
Somerset East
East London
Worcester
Cape Town
Port Alfred
Mosselbaai
Port Elizabeth
Bredasdorp
LESOTHO Member of South African Customs Union
International boundary
Province boundary
National or colonial capital
Province capital
Railroad
Road
0 50 100 150 Miles
0 50 100 150 Kilometers
BOUNDARY REPRESENTATION IS NOT NECESSARILY AUTHORITATIVE
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Table 1

South African Balance of Payments a/

Million US $

	1968/69			1969/70		
	Total	Jul-Dec 1968	Jan-Jun 1969	Total	Jul-Dec 1969	Jan-Jun 1970
Imports	-3,835	-1,902	-1,933	-4,606	-2,243	-2,363
Merchandise	-2,798	-1,376	-1,422	-3,411	-1,658	-1,753
Service payments	-1,037	-526	-511	-1,195	-585	-610
Exports	3,842	1,917	1,925	3,955	2,026	1,929
Merchandise	2,045	1,008	1,037	2,050	1,049	1,001
Net gold output b/	1,120	552	568	1,185	617	568
Gold sales c/	*840*	*287*	*553*	*1,515*	*771*	*745*
Service receipts	527	274	253	570	283	287
Transfers (net)	150	83	67	150	77	73
Net on current account	*7*	*14*	*-7*	*-651*	*-217*	*-434*
Private capital	239	211	28	344	76	268
Long-term	188	160	28	225	70	155
Short-term d/	52	52	0	119	6	113
Balance	*247*	*226*	*21*	*-307*	*-141*	*-166*
Public capital e/	118	48	70	42	-43	85
Long-term	63	46	17	77	20	57
Short-term	54	1	53	-35	-63	28
Changes in reserves f/	*365*	*274*	*91*	*-265*	*-185*	*-80*
Reserves	1,631	1,540	1,631	1,411	1,457	1,411
Gold	1,263	1,243	1,263	942	1,114	942
Foreign currency	368	297	368	469	343	469

a. Because of rounding, components may not add to the totals shown.
b. Valued at the statutory price.
c. Including net gold output, changes in gold reserves, and a gold valuation adjustment. As reported in South Africa's balance-of-payments statistics. Our estimates of sales are somewhat different. The discrepancy arises from differences in the treatment of stocks.
d. Including errors and unrecorded transactions.
e. Including the central government and the banking sector.
f. In order to indicate capital movements more correctly, exchange losses and profits incurred and the initial allocation of special drawing rights are not taken into account in computing "changes in reserves," although they are included in the "reserves" entry.

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4. Gold sales in 1969/70 reached a record level of $1,515 million, $330 million more than current output. These sales covered not only the $265 million overall balance-of-payments deficit but also accounted for $65 million of the increase in South Africa's foreign currency reserves.

5. South Africa's substantial deficit on current account is likely to increase through the second half of calendar year 1970 and the first half of 1971 (see Table 2). Although the expansionary forces in the economy probably are abating somewhat, the rate of growth of domestic expenditure and consequently the rate of growth of imports should remain high. Private consumption expenditure should rise about 6% to 6.5% over the year in real terms and more than 9% in current prices. Although inventory investment is likely to stabilize and may possibly decline as normal stock levels are attained, fixed private investment should grow more rapidly under the stimulus of higher capacity utilization, increased profits, and higher corporate savings; the composition of investment is likely to shift, moreover, away from construction to machinery and equipment with its higher import content. On the basis of surveys of investment intentions, a growth of more than 10% in private fixed investment reasonably can be expected. The combined effect on merchandise imports probably will be an increase of about 5% to 6%.*

6. Although exports are more difficult to predict, a substantial increase in the next few months is not likely. Agricultural output has been hurt by poor weather, and exports of corn, citrus fruits, and wool may be affected adversely. Exports of minerals, particularly diamonds, are likely to suffer from a slackening of world demand. Moreover, conditions of high excess demand should hinder the growth of manufactured exports. Gold production should be roughly unchanged.

7. The current account deficit for 1970/71 probably will be around $800 million; in no case is it likely to be less than the $650 million

* *Based on past relations between imports and national economic aggregates; see Appendix B.*

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Table 2

Balance-of-Payments Projection a/
July 1970 - June 1971

Million US $

Current Account		Capital Account	
Imports	-4,820	Private capital	350
Merchandise	-3,600	Long term	230
Service payments	-1,220	Short term	120
Exports	4,020	*Balance*	*-450*
Merchandise	2,070	Public capital	150
Net gold output	1,190		
Service receipts	600	Long term	150
Transfers (net)	160	Short term	--
Net on current account	*-800*	*Changes in reserves*	*-300*

a. Estimate.

recorded for 1969/70. Offsetting this deficit, we project a private capital inflow of about $350 million and a public capital inflow of about $150 million. On balance we believe that a decline of up to $300 million in gold and foreign exchange reserves is a reasonable estimate for the year ending June 1971. Gold sales by South Africa consequently should continue at a rate well in excess of output.

Balance-of-Payments Prospects and Economic Growth, 1971-75

8. South Africa's foreign and domestic economic policies during the first half of the 1970s will be shaped more by balance-of-payments considerations than has been the case in the past. The Republic can not long continue to lose gold and foreign exchange reserves at an annual rate of $300 million in spite of its relatively strong reserve position and credit standing. To protect its reserves and standing as it has in similar

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situations in the past, Pretoria is likely to restrict the economy's growth so as to slow the growth of imports. Although major reliance probably will be placed on monetary policy, fiscal tools doubtless would be employed also. The most likely timing for the imposition of more restrictive policies would be March or April 1971, when the new budget is presented.

9. To regain balance-of-payments equilibrium, South Africa will have to hold its rate of economic growth not only below recent high levels but probably also below the 5.5% real growth rate projected in the Economic Development Program (EDP). At the planned rate of growth, we calculate that the balance-of-payments deficit, excluding any official borrowing, would exceed $2,300 million for the period.* With such a large deficit, even if South Africa was able to borrow substantial sums abroad, reserves would soon be depleted. Because of the balance-of-payments constraint, we believe the economy's growth is likely to be below 5% in the 1971-75 period, compared with 6% in the 1960s and more than 7% in 1969-70.

10. The Republic's deteriorating balance-of-payments situation is attributable to the stagnation of gold output and the relatively slow development of new exports. Gold output, which in the 1960s financed one-third to one-half of South Africa's merchandise imports, should remain relatively constant at about $1.2 billion for the next several years and may decline subsequently (see Figure 2). Although prospects for other exports are favorable, the growth rate of total exports is unlikely to match the growth in merchandise imports, which probably will more than keep up with the growth of GDP.

11. South Africa's total exports are projected to grow at an average annual growth rate of about 4.4% in constant prices in the 1971-75 period. Although the EDP envisions only about a 5% growth in non-gold mineral exports -- now about $1 billion -- an 8% figure seems more realistic. Prospects are good for substantial increases of 10% to 20% annually

* *The analysis and estimates to support this conclusion are presented in Appendix A.*

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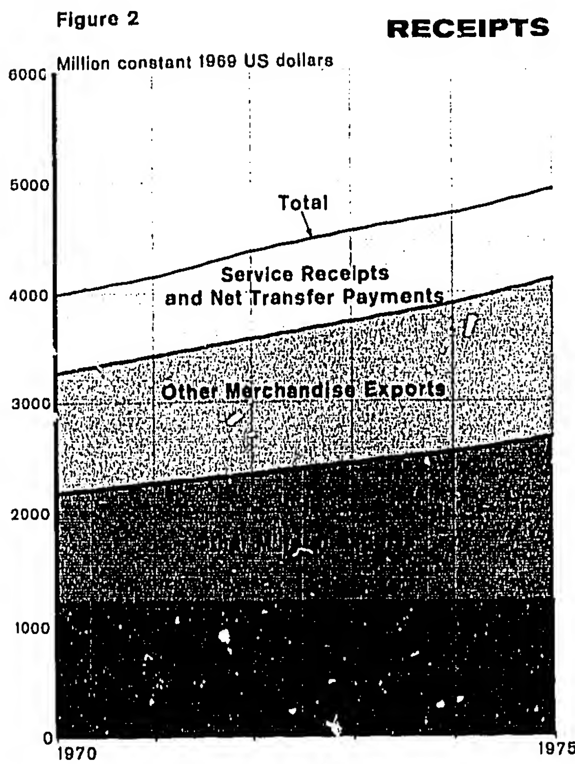

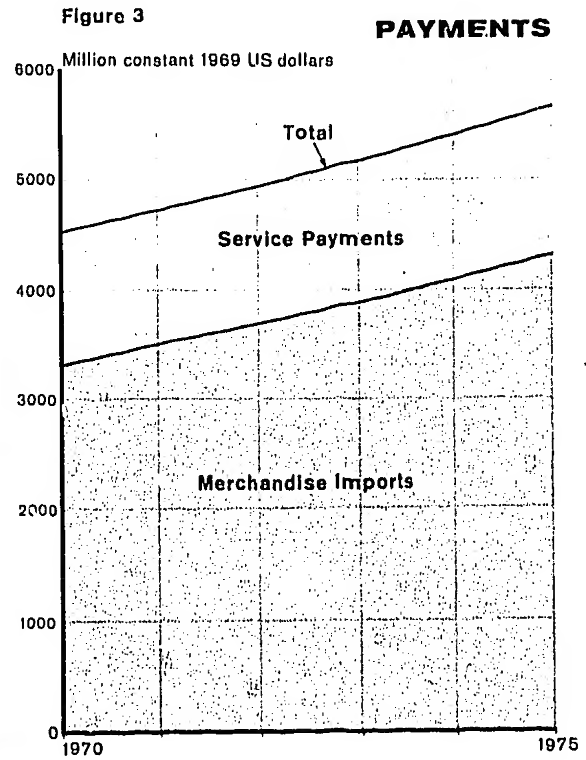

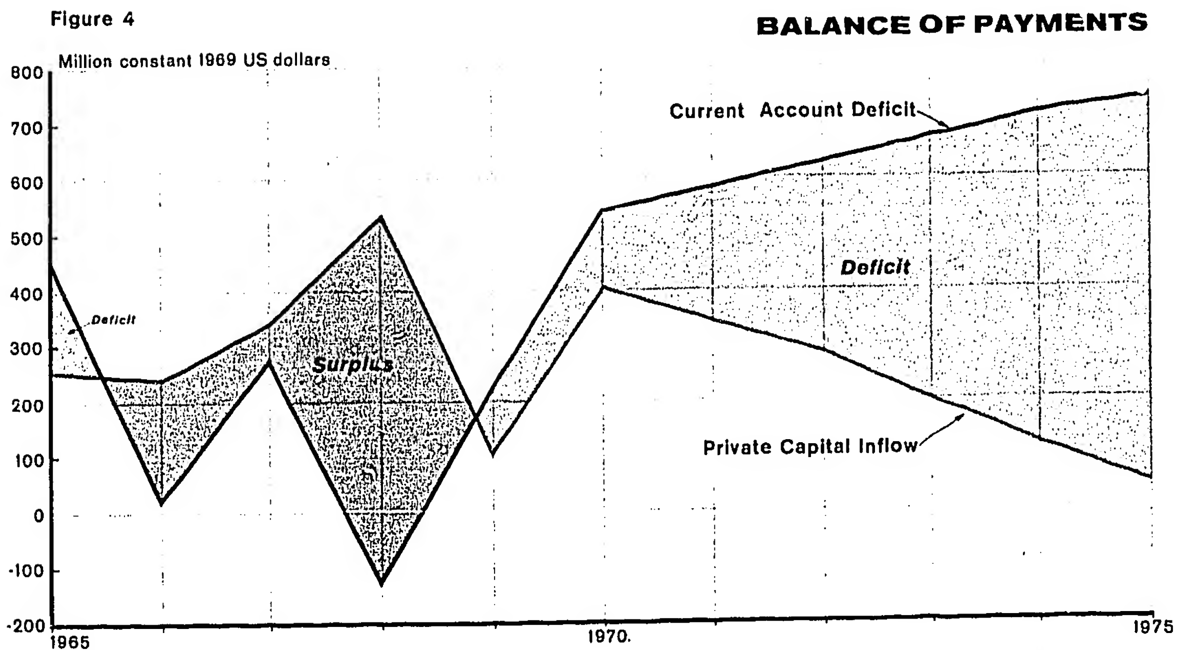

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in iron ore, platinum, and copper exports -- now totaling about $300 million. We expect non-mineral exports -- agricultural and manufactured products -- to increase at an average annual rate of about 5.5%. Service receipts can be expected to continue their 3% growth, as projected in the EDP. The growth in net transfer payments should decline to about 4% annually, since the level of net immigration has been stabilized at 30,000 per year.*

12. If real GDP were to grow at the 5.5% rate projected in the EDP, merchandise imports and service payments combined would grow about 5% annually in 1971-75 (see Figure 3), merchandise imports by about 5.4%, and service payments about 2.5%. Although the import substitution program has been relatively successful in reducing imports of light manufactures, particularly consumer goods, the economy is still heavily dependent on imports for capital goods and transport equipment.

13. At the plan's 5.5% real growth rate for GDP, the deficit in South Africa's balance-of-payments before public capital movements and changes in reserves could be expected to equal $710 million in 1975 (in 1969 prices) -- a level that almost certainly would be unacceptable to the Republic and could not be sustained (see Table 3 and Figure 4). The projection gives a deficit on current account of about $750 million in 1975. Unlike in recent years, there would probably not be a large surplus on capital account with which to offset part of the current account deficit. The private capital inflow -- principally stock exchange transactions and direct long-term investment by foreigners -- is likely to decline, because of the deterioration in the Republic's reserve position and the long-term trend toward capital self-sufficiency. We project an inflow of only about $40 million in 1975, compared with about $340 million in 1969/70.

External Relations and the Balance of Payments

14. Two major developments likely to affect the structure of South Africa's trade during 1971-75 may well aggravate the already tight balance-of-payments situation. First, the Republic is obligated by its commitments under the General Agreement on Tariffs and Trade (GATT) to remove import

* *See Appendix A.*

Table 3

Estimated Balance of Payments in 1975
With 5.5% Growth in GDP

Million Constant 1969 US $

Current Account		Capital Account	
Imports	-5,680	Private capital	40
Merchandise	-4,320	Long term	60
Service payments	-1,360	Short term	-20
Exports	4,930	*Balance*	*-710*
Merchandise	2,910		
Net gold output	1,200		
Service receipts	640		
Transfers (net)	180		
Net on current account	*-750*		

quotas that now cover about 70% of South Africa's imports and probably restrict effectively about a quarter of those covered. Second, if the United Kingdom enters the European Community, the Republic may have to accommodate itself to the loss of tariff preferences in its most important export market.

GATT Negotiations

15. The International Monetary Fund in November 1969 found that recourse by South Africa to GATT Article XII permitting quantitative import restrictions for balance-of-payments reasons was no longer justified. The Republic consequently is obligated to remove or regularize its residual import restrictions and now is engaged in bilateral consultations with the United States and its other trading partners to this end.

16. South Africa has announced its desire to modify or withdraw a large number of tariff concessions previously granted. South Africa's intent is to offset the loss of quantitative import controls by negotiating the freedom to grant equivalent

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tariff protection. Although under GATT procedures South Africa is obligated to offer full compensation for all tariff concessions withdrawn or for the maintenance of illegal import restrictions, the Republic has stated its inability to do so and has asked that it be treated as a less developed economy for the purpose of negotiation.

17. Full compensation has been demanded by South Africa's major trading partners, including the United States, for whom about $100 million of annual trade would be impaired by the withdrawals; only about $30 million in compensation has been offered. In the event that agreement can not be reached -- only the United Kingdom is moving toward an agreement on a conventional basis -- the Republic's trading partners could make retaliatory withdrawals of concessions. The ability to do so is limited, however, given the commitment to the most-favored-nation concept in trade, since South Africa is a principal supplier of very few commodities, and tariffs could not be raised on South Africa's exports without also hurting other suppliers. More likely, South Africa will be pursuaded to remove most of its residual import restrictions and to negotiate its withdrawals of tariff concessions in stages reflecting specific needs, rather than seeking sweeping changes now.

British Entry into the Common Market

18. Under the Commonwealth Preference System, South Africa has preferred access to the British market, and nearly all of the Republic's exports currently enter the United Kingdom duty free. British membership in the Common Market presumably would require revision and eventually the ending of the Commonwealth Preference System. This change may affect adversely the Republic's exports, about one-third of which are destined for the United Kingdom.

19. The most vulnerable commodities are those admitted duty free or at a reduced rate into the United Kingdom under tariff preference and which are dutiable in the Community. Included in this group, which makes up about 45% of South Africa's total exports to Britain, are most of the Republic's agricultural exports. The canned fruit industry,

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in particular, faces serious problems, since about 70% of South Africa's canned fruit exports -- almost $40 million -- go to the United Kingdom, which imposes tariffs on competing imports from outside the Commonwealth. The Common Market countries and other countries that have been granted tariff preferences by the Community, furthermore, have considerable potential for expanding canned fruit production, and a high, common, external tariff should provide the incentive for Europeans to capture a large share of the British market. Exports of deciduous and citrus fruits may also be hard hit, although South Africa enjoys a seasonal advantage over Northern Hemisphere suppliers. Exports of sugar, wine, and meat also are likely to be affected adversely.

20. Britain's entrance into the Common Market may aggravate an already tight balance-of-payments situation, but it should not cause insurmountable problems for South Africa. Since agricultural exports to the United Kingdom account for only about 10% of South Africa's merchandise exports, the decline in total merchandise exports should not be large. The overall effect on the balance of payments should be even smaller since South Africa will be able, after the United Kingdom enters the Community, to raise tariffs on British exports now imported under tariff preference.

Restructuring of Trade Patterns

21. If the South African economy is to achieve the growth that its domestic resources will permit, its trade patterns must be restructured. To reduce the high proportion of imports in both consumption and fixed investment and at the same time provide a new growth point in the economy and a new source of exports, the Republic will have to stimulate the broader development of manufacturing, particularly heavy industry. At present, imports of capital equipment and intermediate products destined for manufacturing substantially exceed manufacturing exports. Although gold and other minerals will long be South Africa's dominant exports, manufacturing will have to become increasingly self-sustaining in the 1971-75 period and beyond. In the 1970/71 budget, provision is made for a larger government

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subsidy for private export development expenditures and for export financing for manufactures, but the subsidy still is relatively small, and it probably cannot be increased substantially given worldwide opprobrium to subsidized exports.

22. The efficient expansion of manufacturing will in many cases require markets larger than those provided by the South African economy itself. The most obvious source of such markets is elsewhere in Africa, particularly in southern Africa. Exports to Africa already represent about 17% of South Africa's total exports and about 28% of exports of manufactured goods. South Africa is a principal supplier of Rhodesian imports and is seeking actively to expand its exports to the Malagasy Republic, Malawi, and other Black African states as well as to maintain its favorable trading relations with Zambia. Security considerations take precedence over economics in South African thinking, however; foreign policy is directed at preventing an unfriendly regime or a strong insurgency movement from emerging in a border country, even if the result is reduced access to other markets in Africa.

23. South Africa's most logical markets, given political considerations, may be the other developed and developing countries in the Southern Hemisphere. The South African authorities are conscious of possible political obstacles to the development of markets in Africa and are consequently concentrating on building closer Southern Hemisphere ties for political as well as economic reasons. Although exports to Australia and New Zealand now represent less than 2% of South Africa's total exports, long-term growth prospects are good because these countries are at a similar stage of economic development and face similar economic problems. South Africans already have been invited to invest in Argentina, direct air service has been established with Brazil, and the Republic has given permission for South Africans to invest in Australia and New Zealand and has sought to strengthen both formal and informal ties with these countries.

24. South African exports to Japan also are likely to increase in the 1970s, but Japanese imports will continue to be concentrated in raw

materials rather than manufactures. Japan is now the Republic's second largest customer -- it accounts for about 10% of South Africa's exports -- and, if present trends continue, it will be the Republic's most important trading partner by the end of the 1970s. South Africa is unlikely, however, for political, economic, and ideological reasons to seek to integrate its economy more closely to the Japanese. Japan and South Africa have not exchanged ambassadors, have no trade agreement, and do not at present grant each other most-favored-nation treatment.

Conclusions and Prospects

25. In the face of an increasing drain on its gold and foreign exchange reserves, the South African government is likely to restrict the growth of the economy in 1971. South Africa's current account deficit probably will be around $800 million in 1970/71, $150 million greater than the record 1969/70 deficit. A projected private capital inflow of about $350 million and a public capital inflow of about $150 million would offset only part of this deficit and a loss of $300 million in gold and foreign exchange reserves is expected. To slow the drain in reserves, Pretoria probably will seek to slow the growth in imports by holding economic growth well below the recent high rate of more than 7%.

26. Balance-of-payments problems, reflecting mainly the leveling off of gold production, are likely to restrict the economy's growth at least through 1975. South Africa would probably incur substantial balance-of-payments deficits if the economy continued to grow at the 6% rate of the 1960s or even at the 5.5% rate projected in the Economic Development Program. A decline in the rate of growth to below 5% is probably necessary to achieve balance-of-payments equilibrium. This slowdown may begin in mid-1971.

27. Balance-of-payments prospects are aggravated by the need under the GATT to remove residual import restrictions and by the possible loss of Commonwealth Tariff Preferences because of British entry into the Common Market. Fortunately for South Africa, the impact is likely to be relatively

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small in both cases. In the GATT negotiations, South Africa probably will be persuaded to remove many of its residual import restrictions and to negotiate offsetting withdrawals of tariff concession in stages reflecting specific needs. British entry into the European Community should lead to a slight decline in South Africa's exports and a partially offsetting decline in the Republic's imports from Britain.

28. The deteriorating balance-of-payments situation and the concomitant need to slow the growth of the economy will force South Africa to seek new export opportunities particularly for manufactured products. Any significant increase in exports probably will require the development of new trade patterns and alliances. The Republic probably will seek to improve its economic relations with the rest of Africa as well as to strengthen its ties with Australia, New Zealand, and other Southern Hemisphere countries.

29. Foreign exchange stringency may force the South Africans to devalue their currency. A Rand devaluation probably would not have a very significant effect on export earnings, because mineral output, as a result of the peculiarities of mining technology, is not very responsive to cost changes. The effect of a devaluation on imports might be significant, however, and in the longer term exports of manufactures would be stimulated. A possibility exists, therefore, that the South Africans may devalue their currency in the 1971-75 period, but they will probably not take such a drastic step without first exhausting their other options.

30. The economic slowdown is likely to reduce domestic pressures for a relaxation of apartheid practices. Since the supply and planned distribution of labor during the first half of the 1970s appears to be adequate to achieve the projected rate of real growth in GDP of 5.5% a year -- a rate greater than that consistent with long-term balance-of-payments equilibrium -- economic pressures to force a relaxation of apartheid practices are likely to diminish.* Indeed, if foreign exchange

* *For a comprehensive discussion of South Africa's growth possibilities in 1971-75 with the present system of labor* [footnote continued on p. 16].

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shortages should force a marked economic slowdown, white labor probably would press for even tighter restrictions on non-white employment to protect its position.

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segregation remaining essentially unchanged, see ER IM 70-116, South Africa: The Economic Cost Of Apartheid, *September 1970, CONFIDENTIAL.*

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APPENDIX A

Balance-of-Payments Prospects During 1971-75 Under the Assumption of 5.5% Growth in GDP

General

Under the Economic Development Program (EDP) for 1968-73, the South African economy is to grow in real terms at an annual rate of 5.5% compared with the 6% achieved in the last decade and more than 7% in 1969-70. If the economy should grow at the projected 5.5% rate, we estimate the balance-of-payments deficit before changes in reserves and public capital inflow would exceed $2,300 million for the 1971-75 period (see Figure 4).

This estimate is derived from projections made of the individual balance-of-payments components for the 1971-75 period under the assumption of 5.5% growth in GDP. For merchandise imports, service payments, and capital flows, the projections were made on the basis of estimates of the individual expenditure components and of the relationship between these components and the balance of payments as determined by means of regression analysis (for methodology, see Appendix B). In the case of exports and service receipts, the projections were based on past trends and known developments likely to have an important impact in the next five years.

Imports and Service Payments

If GDP grows at the projected 5.5% rate, total expenditure, excluding expenditure by government, will grow at an average annual rate of about 5.3% in constant prices in the 1971-75 period. Correspondingly, on the basis of the relationship derived in the EDP, net national income would grow at about 5.2%. We expect that private consumption, which is closely tied to net national income, would also grow at about 5.2%.

Net private fixed investment would grow about 7% in 1971 and 1972, when business expects to expand its investment considerably, and by 5% thereafter,

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assuming that the then current level of utilization is the desired one. Gross private fixed investment, given the relationship between net and gross investment developed in the EDP, would grow about 8% in 1971 and 1972 and about 6% in the remainder of the period. Inventory investment probably would remain relatively constant in absolute terms through 1971 and 1972, since stock levels are not relatively high. After 1972, inventory investment could also be expected to grow about 5.5% annually (see Table A-1).

Table A-1

National Economic Aggregates at 5.5% Growth in GDP

	Private Consumption	Gross Private Fixed Investment	Inventory Investment	Imports
	Million Constant 1969 US $			
1969	10,060	1,930	290	3,080
1970 (estimated)	10,920	2,130	290	3,315
1971	11,490	2,290	300	3,510
1972	12,080	2,460	300	3,710
1973	12,710	2,600	320	3,900
1974	13,370	2,740	330	4,100
1975	14,070	2,890	350	4,320
	Percent			
Average annual rate of growth, 1971-75	5.2	6.3	3.8	5.4

Assuming a 5.5% growth of GDP, the growth of merchandise imports is projected at an average annual rate of about 5.4%. The derived relationship between imports and the components of domestic expenditure shows that for every $10 million increase in private consumption, imports increase by $2 million, for every $10 million increase in

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fixed investment, imports increase by $6.7 million, and for every $10 million increase in inventory investment, imports increase by $5.4 million. These measures of the impact of increased domestic expenditure on imports, when combined, are well above the actual average ratio of imports to GDP (about 20%). A partially offsetting factor, however, is the government's import substitution program, which is reducing imports for a constant level of product and investment by more than $35 million a year.

If both GDP and imports grow at their projected rates, we calculate that service payments for freight, insurance, and other imported services would increase in constant prices at an average annual rate of only about 2.5%. Service payments for freight and insurance are related closely to merchandise imports, while other service payments including investment income paid to foreigners appear to be closely related to Gross Domestic Expenditure and the rate of interest (a measure of the rate of return). We assume that interest rates remain essentially unchanged.

Exports and Service Receipts

The growth rate of exports, including net gold output, service receipts, and transfers, could not match the relatively rapid growth in merchandise imports and service payments projected for 1971-75 under the assumption of a 5.5% growth in GDP.

Mineral exports probably will increase in constant prices at an average annual rate of about 4.2% during 1971-75. In the absence of major new discoveries, gold output should remain constant for the next several years and then probably decline. Two new mines began operating in 1968 and 1969 and three additional mines are under development. The new mines are relatively small, however, and their output probably will just offset the decline in output of some of the older mines. As stated in the text, non-gold mineral output should grow about 8% annually.

We project the growth of non-mineral exports -- agricultural and manufactured products -- at an average annual rate of about 5.5%. Such an increase

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in agricultural exports appears to be reasonable under normal climatic conditions, considering that the volume of agricultural exports increased at an average rate of 6% during the postwar years. A growth rate of 5.5% is forecast in the Development Program. Although exports of manufactured products increased 7% during the 1960s and the EDP envisions a similar increase in 1968-73, this projection seems a bit high, as markets for South African manufactured products in Rhodesia and Zambia are unlikely to grow at the same rate as in the 1960s.

South Africa's total exports, including service receipts and net transfers, are projected to grow at an average annual rate of about 4.4%. The combined exports of gold, other minerals, agricultural products, and manufactured products are projected at a growth rate of about 4.6%. Service receipts, which probably grew less than 3% annually in the 1960s, aside from the windfall increase as a consequence of the Suez closure, can be expected to continue their 3% growth, as is projected in the EDP. Net transfer payments, consisting to a large extent of funds brought in by immigrants, should grow less rapidly than in the 1960s, since the level of net immigration has been stabilized. A reasonable estimate is a growth in net transfers of about 4% annually, or at about the same rate as exports in general.

Current Account Deficit

These projections yield a deficit on current account in constant prices of about $750 million in 1975. Merchandise imports and service payments would equal $5,680 million in 1975 while merchandise exports, net gold output, service receipts, and net transfer payments would equal $4,930 million. The deficit, although increasing throughout the period, probably would be smaller than in 1970/71 when, because of unusually rapid economic growth associated with an expansionary phase of the business cycle, it is expected to be about $800 million.

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Capital Inflow

The deficit on current account, unlike the experience in recent years, is not likely to be offset by a large surplus on capital account. It is extremely difficult to predict capital flows over a five-year period because they are affected not only by economic conditions in South Africa but also by economic conditions elsewhere, as well as by political, psychological, and administrative changes. Nevertheless, we project a large decline in private capital inflows from about $340 million in 1969/70 to only about $40 million in 1975.

A decline in both the long- and short-term private capital inflow can probably be expected because of a projected deterioration in the Republic's reserve position and a long-term trend toward increased capital self-sufficiency. The long-term inflow appears to be related to interest rates in South Africa, the level of imports, the level of reserves (probably a measure of currency stability, as well as a proxy for the trend in government economic policy), and time. Assuming that interest rates remain essentially unchanged, that GDP grows at the projected 5.5% rate and imports at the projected 5.4% rate, and foreign exchange and gold reserves decline by about $200 million annually,* we project the long-term private capital inflow to decline from $225 million in 1969/70 to approximately $60 million in 1975 (in 1969 prices). Private short-term capital inflows (including errors and unrecorded transactions) can be related to the level of imports (many of which are financed by foreign borrowing), the level of reserves, and time. Under the same conditions, we project a shift to a net short-term capital outflow.

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* *The assumption that the Republic's gold and foreign exchange reserves decline by about $200 million annually is consistent with the balance-of-payments projection, including the projection on capital account.*

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APPENDIX B

Methodology

The determinants of the elements of the balance of payments were estimated using simple least square regressions for a time series of annual observations for the 1946-69 period. The values obtained for the parameters and test statistics are presented below.

(1) $M = 409.17 + .20\ PC + .67\ FI + .54\ II - 35.92\ t$
(3.45) (3.34) (3.23) (4.27) (3.05)

$R^2 = .95$ dw = 1.84 df = 18

(2) $S_1 = 59.19 + .08\ M - 4.33\ t$
(7.14) (13.72) (10.68)

$R^2 = .90$ dw = 2.13 df = 21

(3) $S_2 = 63.58 + .02\ GDE + 39.05\ r + 8.87\ t$
(1.34) (3.05) (3.55) (3.50)

$R^2 = .97$ dw = 1.30 df = 20

(4) $STK = -25.72 + .10\ R + .05\ M - 8.68\ t$
(0.64) (4.19) (1.74) (4.72)

$R^2 = .73$ dw = 2.14 df = 18

(5) $LTK = -603.07 + .39\ R + .30\ M + 63.36r - 44.52\ t$
(3.55) (5.55) (3.62) (1.98) (7.41)

$R^2 = .86$ dw = 1.97 df = 17

(6) X = exogenous

Note:

$S_1 + S_2 = S$

$X - (M + S) = CAB$

$CAB + LTK + STK = B$

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Where:

M = Merchandise imports (in million constant 1969 US dollars)
PC = Private consumption expenditure
FI = Private fixed investment
II = Inventory investment
t = Time (in years since 1946)
S_1 = Service payments for freight and merchandise insurance
S_2 = Other service payments
GDE = Gross domestic expenditure
r = Rate of interest (percentage rate)
STK = Private short-term capital inflow (net)
LTK = Private long-term capital inflow (net)
R = Level of gold and foreign exchange reserves
X = Exports
S = Total service payments
CAB = Current account balance
B = Balance (excludes public capital movements and changes in reserves)
R^2 = Measure of the explanatory ability of the function, proportion of the variation in the dependent variable explained by the linear influence of the independent variables
dw = Durbin-Watson d statistic; measure of the degree of first order auto-correlation of the residual (should be near 2)
df = Degrees of freedom; number of observations minus number of variables

Numbers in parentheses are Student t statistics; all coefficients are significantly different from zero at the 95% level except constants in equations (3) and (4).

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